FILED
MAY 17 1991
OFFICE OF THE CLERK

No. 90-1450

In the Supreme Court of the United States

OCTOBER TERM, 1990

GLK, INC., PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTION PRESENTED

Whether a provision in petitioner's plan of reorganization that allocated tax payments to the "trust fund" portion of petitioner's federal tax liabilities was properly stricken by the bankruptcy court based on its finding that such an allocation was not necessary to the success of the reorganization plan.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-2a) is reported at 921 F. 2d 967. The findings of the bankruptcy court on remand (Pet. App. 3a-7a), the memorandum opinion of the bankruptcy appellate panel (Pet. App. 8a-11a), and the original order of the bankruptcy court (Pet. App. 12a-13a) are unreported.

JURISDICTION

The judgment of the court of appeals was entered on December 28, 1990. The petition for a writ of certiorari was filed on March 15, 1991. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. On April 26, 1987, petitioner GLK, Inc., filed a petition for reorganization under Chapter 11 of the Bankruptcy Code (11 U.S.C.). Pet. App. 9a. The Internal Revenue Service ("IRS") filed a proof of claim in the bankruptcy court for delinquent pre-petition taxes, interest, and penalties totalling approximately $309,000. The delinquent taxes consisted of both "trust fund" and "non-trust fund" taxes. "Trust fund" taxes are those income and social security taxes that an employer is required to withhold from the wages of employees and pay over to the government. If the persons responsible to collect, account for, and pay over "trust fund" taxes willfully fail to do so, they are personally liable for a penalty in the full amount of the unpaid "trust fund" taxes (26 U.S.C. 6672). Pet. App. 9a-10a.

2. The debtor proposed a plan of reorganization that contained a provision designating that payments to the IRS would be "applied first to any 'trust fund' liability." Since the IRS collects the full amount of a trust fund delinquency only once (whether the payment is made by the corporation or by the responsible persons (*USLIFE Title Ins. Co.* v. *Harbison*, 784 F.2d 1238, 1243 (5th Cir. 1986))), application of tax payments first to the "trust fund" liability would reduce or extinguish the associated liability of the responsible individuals. The government objected to this provision of the proposed plan, arguing that payments made under a plan of reorganization are involuntary and that the debtor is therefore not entitled to designate how they are to be applied. Pet. App. 4a. In confirming the plan, the bankruptcy court upheld the government's objection, struck the designation provision in the plan and ruled that the IRS could apply the payments under the plan as it deemed appropriate. Pet. App. 12a-13a.

3. The Bankruptcy Appellate Panel for the Ninth Circuit affirmed. The panel held that payments made under the plan to the IRS were involuntary and, therefore, were not subject to designation by the debtor. Pet. App. 8a-11a (citing, *e.g.*, *United States* v. *Technical Knockout Graphics, Inc.*, 833 F.2d 797 (9th Cir. 1987)).

4. Petitioner appealed to the Ninth Circuit. While the appeal was pending, this Court decided *United States* v. *Energy Resources Co.*, 110 S. Ct. 2139 (1990). In *Energy Resources*, this Court held that bankruptcy courts "may order the IRS to apply tax payments to offset trust fund obligations where it concludes that this action is necessary for a reorganization's success." *Id.* at 2143. The Ninth Circuit therefore remanded this case to the bankruptcy court for it to determine whether designation of tax payments to the "trust fund" portion of petitioner's tax liability was necessary to the success of the plan of reorganization. Pet. App. 2a.

The bankruptcy court concluded that allocation of tax payments to petitioner's "trust fund" liabilities "is not necessary to the success of the Plan" (Pet. App. 4a). Such an allocation was not necessary to permit petitioner's officers to carry out their responsibilities in the reorganized corporation because the parties had stipulated that the IRS would take no action to enforce the liability of the responsible officers so long as (i) those officers agreed to extend the limitations period for the liability and (ii) petitioner made the tax payments required under the plan. The bankruptcy court further noted that an allocation apparently was not necessary for the reorganization to succeed, since petitioner had been complying with its confirmed plan without such a provision for almost three years. Pet. App. 3a-7a.

5. The Ninth Circuit affirmed. The court of appeals held that, in view of the bankruptcy court's finding that an allocation of tax payments to "trust fund" liabilities was not

necessary to the success of the reorganization, the bankruptcy court properly struck the designation provision from the plan. Pet. App. 2a.

ARGUMENT

The decision in this case is correct and does not conflict with any decision of this Court or of the other courts of appeals. This case represents no more than an application of this Court's decision in *Energy Resources* to the specific facts of this case. Further review is therefore not warranted.

1. In *Energy Resources*, this Court stated at three separate points in its opinion that a bankruptcy court may direct the application of tax payments made by a Chapter 11 debtor to the "trust fund" portion of the debtor's federal tax liability "where the bankruptcy court determines that this designation is necessary for the success of a reorganization plan." 110 S. Ct. at 2140. See *id.* at 2142, 2143. Accordingly, the court of appeals remanded this case for the bankruptcy court to consider whether the designation of tax payments to the "trust fund" portion of the petitioner's tax liability was necessary for the success of the reorganization plan. Pet. App. 2a. The bankruptcy court found that such an allocation was *not* necessary in this case, since the debtor had been operating successfully under its confirmed plan without a designation provision for almost three years and since (pursuant to the parties' stipulation) there was no danger that the IRS would commence collection action against the debtor's officers so long as the reorganization continued successfully. Pet. App. 3a-7a. The bankruptcy court's findings are amply supported by the record.

The debtor now contends (Pet. 7-11) that, notwithstanding this Court's contrary holding in *Energy Resources*, a finding of "necessity" should not be required to support an allocation of tax payments to "trust fund" obligations. In

petitioner's view, a requirement of necessity "adds an undue and inappropriate restriction on and impediment to reorganization plans" (Pet. 20). Petitioner's dissatisfaction, while couched in terms of criticism of the decision of the court of appeals, is in fact directed at this Court's decision in *Energy Resources*. The "necessity" requirement of which petitioner complains is an integral aspect of the *Energy Resources* decision; its function is to strike a reasonable balance between the competing interests of the IRS and the debtor. Where an allocation of payments is not necessary for the success of a plan of reorganization, there are no countervailing bankruptcy policy considerations to justify disregard of the tax enforcement policy of holding responsible the individuals who have allowed "trust fund" taxes to be misappropriated. See *United States* v. *Technical Knockout Graphics, Inc.*, 833 F.2d at 803.

2. Petitioner complains that the court of appeals should have addressed the claim that there is a common law right to require the IRS to allocate its payments under the confirmed reorganization plan. Petitioner acknowledges (Pet. 17), however, that the courts of appeals have uniformly held that a debtor has no right to direct the application of tax payments under a confirmed Chapter 11 plan because such payments are involuntary. *IRS* v. *Energy Resources Co.*, 871 F.2d 223, 230 (1st Cir. 1989); *DuCharmes & Co.* v. *Michigan*, 852 F.2d 194, 196 (6th Cir. 1988); *United States* v. *Technical Knockout Graphics, Inc.*, 833 F.2d at 802; *In re Ribs-R-Us, Inc.*, 828 F.2d 199, 203 (3d Cir. 1987). See also *Jehan-Das, Inc.* v. *United States*, 925 F.2d 237 (8th Cir. 1991).[1] Petitioner simply claims that all of these cases

[1] The only contrary appellate decision (*United States* v. *A & B Heating & Air Conditioning, Inc.*, 823 F.2d 462, 465 (11th Cir. 1987)) was vacated by this Court and remanded for consideration of mootness. 486 U.S. 1002 (1988). The debtor moved to delete the designation pro-

were wrongly decided because they have not followed what petitioner perceives to be the "common law" rule (Pet. 9), under which, according to petitioner, a debtor's ability to designate the application of a payment turns not upon whether the payment is voluntary or involuntary, but upon whether the debtor has "control" over the funds with which the payment is made (Pet. 9-10).

The short answer to petitioner's "common law" theory is that this case involves rights and obligations arising under statutes, not under the common law. There is no common law analogue to priority tax payments made pursuant to a Chapter 11 reorganization plan.[2] A reorganized corporation, bound by the dictates of a confirmed plan, is different in crucial respects from a debtor making a pre-bankruptcy payment. The courts that have considered the proper balancing of these statutory rights and obligations have uniformly reached the conclusion that the debtor in bankruptcy has no general right to direct the application of payments. See page 5, *supra*. Petitioner points to no conflict among the courts of appeals on this question to justify the exercise of this Court's discretionary jurisdiction.

3. Petitioner has also failed to establish the existence of any conflict with respect to the application of *Energy*

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vision from its Chapter 11 plan, and the court of appeals ordered the case to be dismissed as moot. 878 F.2d 1311 (11th Cir. 1989). That case thus lacks any precedential value. See *County of Los Angeles* v. *Davis*, 440 U.S. 625, 634 n.6 (1979).

[2] Even under the "common law" theory that petitioner espouses, it is difficult to conceive that a debtor in bankruptcy has "control" over the disposition of its assets. A debtor that has sought the protection of Chapter 11 does not have the power to refuse to pay its creditors; it is compelled by the bankruptcy court's confirmation order to make the tax payments required in the plan. Moreover, payments sufficient to extinguish these tax liabilities are required to be included in the plan by provisions of the Bankruptcy Code. 11 U.S.C. 1129(a)(9)(C).

Resources among the lower courts.[3] Indeed, the decision below is the first by an appellate court to apply this Court's holding in *Energy Resources* that a designation provision is to be approved if it is found "necessary for the success of a reorganization plan." 110 S. Ct. at 2140. Because no conflict exists, further review by this Court is not warranted.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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MAY 1991

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[3] Petitioner complains that the decision in this case reaches a different result than was reached in *Energy Resources* (Pet. 7-8). Petitioner argues that it is "in the same position as Newport Offshore, Ltd., * * * [one of the debtors] in *Energy Resources*," in that both filed Chapter 11 plans containing a designation provision. Pet. 7. But decisions under the standard adopted in *Energy Resources* ("necessary for the success of a reorganization plan") will inherently turn on factual findings peculiar to each separate case. The findings made by the bankruptcy court here—that petitioner had operated successfully for three years under a confirmed plan without a designation provision and that there exists no danger that the IRS will initiate collection action against petitioner's responsible persons during petitioner's continued compliance with its plan—are obviously specific to the facts of this case. No comparable findings were made concerning Newport Offshore, and the court of appeals in *Energy Resources* was satisfied that the record contained adequate support for the bankruptcy court's order. *IRS* v. *Energy Resources Co.*, 871 F.2d 223, 234 (1st Cir. 1989).

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